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No. 809

In the Supreme Court of the United States

OCTOBER TERM, 1959

PAUL E. KERN, JEROME PRINCE AND CHARLOTTE HEINE, PETITIONERS

v.

THE COLUMBIA GAS SYSTEM, INC., ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. 4c–20c) is not yet reported. The oral opinion (R. 66a–69a) of the district court is not reported.

JURISDICTION

The judgment of the court of appeals was entered on January 27, 1960. The petition for a writ of certiorari was filed on March 22, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether in a reorganization under Chapter X of the Bankruptcy Act the court must set down for

hearing a proposed amendment to an unconsummated reorganization plan where the amendment would provide a sufficient increase in the estate to permit full payment in cash of the residual participant under the plan and would permit substantial participation by juniors.

STATUTES INVOLVED

Sections 222 (52 Stat. 898, 11 U.S.C. 622) and 229 (66 Stat. 431, 11 U.S.C. 629) of Chapter X of the Bankruptcy Act are set forth at Pet. 1c, 3c.

STATEMENT

This case arises out of proceedings under Chapter X of the Bankruptcy Act (11 U.S.C. 501 *et seq.*) involving the debtors Inland Gas Corporation ("Inland"), Kentucky Fuel Gas Corporation ("Kentucky Fuel"), and American Fuel and Power Company ("American Fuel").[1] Substantially all the assets involved are owned by Inland, whose stock in turn is held 72.6% by American Fuel and 26% by Kentucky Fuel.[2] Columbia Gas System, Inc. ("Columbia") owns most of the stock of American Fuel and substantial amounts of the debt securities of each of the debtors. By reason of Columbia's inequitable conduct, after gaining control of the debtors, in forcing receivership proceedings against them in order to eliminate their competition, Columbia's claims have been subordinated to those of all public creditors of the

[1] The Securities and Exchange Commission is a statutory party to the proceedings pursuant to § 208 of the Bankruptcy Act (11 U.S.C. 608).

[2] The remaining 1.4% is held by public stockholders.

debtors: *Columbia Gas and Electric Corporation* v. *United States*, 151 F. 2d 461, 468 (C.A. 6); *In re American Fuel and Power Company*, 122 F. 2d 223, 228–229 (C.A. 6); *In re Inland Gas Corporation*, 187 F. 2d 813 (C.A. 6). In effect, the public creditors of American Fuel and Kentucky Fuel were treated as "quasi-creditors" of Inland entitled to be paid out of Inland's assets prior to Columbia. *In re Inland Gas Corporation, supra*, at 817.

During the course of the reorganization proceedings, Inland's properties have greatly increased in value and out of the proceeds of the trustee's operation all of the direct creditors of Inland other than Columbia have been paid in full. Three classes of creditor remain (all figures approximate): (1) public securityholders with claims against American Fuel for $1.9 million principal and $3 million interest; (2) public securityholders with claims against Kentucky Fuel for $2.5 million principal and $4.9 million interest; and (3) Columbia, with claims against Inland for $2.2 million principal, $3.6 million interest on secured claims, and $500,000 interest on unsecured claims.[2]

In June 1958, the district court confirmed a reorganization plan based on a December 31, 1957, valuation of the enterprise of $11 million. The plan

[2] Columbia also has claims against American Fuel and Kentucky Fuel, but those claims have never been recognized as claims against Inland's assets. The only reason for treating the public creditors of the holding companies as "quasi-creditors" of Inland was to prevent Columbia from taking ahead of them; patently that principle cannot be applied to make Columbia itself a quasi-creditor of Inland as to its claims against the holding companies.

provided for payment of administration expenses and distribution of the balance as follows:

> 1. Full payment in cash of both principal and interest (total, $4.9 million) to the public creditors of American Fuel;
>
> 2. Payment in cash of principal only ($2.5 million) to the public creditors of Kentucky Fuel; and
>
> 3. Distribution of common stock valued at $3 million to Columbia on its claims for principal and secured interest totalling $5.8 million.

The Kentucky Fuel public creditors challenged the plan, contending that they were entitled to payment of their postbankruptcy interest claims of $4.9 million prior to participation by Columbia. The court of appeals rejected that contention, holding that an unsecured creditor is not entitled to postbankruptcy interest before payment of a junior (here, subordinated) creditor. *In re Inland Gas Corporation,* 262 F. 2d 510, certiorari denied, 359 U.S. 979. Since the principal and secured interest claims of the junior creditor (Columbia) were greater than the value of the balance of the estate, there was nothing left for payment on the interest claims of the Kentucky Fuel public creditors.

Shortly after the denial of certiorari from the decree confirming the plan and before any steps had been taken to consummate the plan, the Kentucky Fuel public creditors, petitioners here, presented to the district court under §§ 222 and 229 of Chapter X (11 U.S.C. 622, 629) a petition to modify the plan to take into account a $3.6 million increase in the value of the estate since the plan had been confirmed.

The proposed modification was supported by commitments of responsible bankers and underwriters to make available, through the sale of stocks and bonds of the reorganized company, over $9 million in cash. That offer, together with the cash on hand, would produce for reorganization purposes a total (as of August 31, 1959) of $14.6 million instead of the $11 million valuation on which the confirmed plan was based, and would leave a substantial surplus (some $700,000) after payment *in full* of Columbia's $5.8 million claim. To give effect to that increased value available for distribution, petitioners proposed a modification of the plan under which Columbia, instead of receiving common stock valued at only $3 million, would be paid in cash its entire $5.8 million claim (principal and secured interest) and the Kentucky Fuel creditors would receive, for their principal and in partial payment of their interest claims, the residual common stock interest in the reorganized corporation (with an option to receive cash instead of stock).

The district court, ruling only on the "legal premises" of the petition for modification (R. 78a), denied a hearing on the merits of the proposed modifications for the reason that the modifications "are predicated solely on an asserted right on the part of the public holders of Kentucky bonds and debentures to post-bankruptcy interest * * * and that such asserted right has already been adjudicated adversely to [them] * * *, and also, that said Amendments and Modifications are not congruent with the Plan, for the reason, among others, that they are based on principles

contrary to the principles of the Plan, and contrary to the principles established by the Court of Appeals in these proceedings". (R. 77a–78a). The court of appeals, with Judge Miller dissenting, affirmed (Pet. 4c–20c).

DISCUSSION

After confirmation but before consummation of a Chapter X reorganization plan, responsible bankers tendered underwriting commitments that would make available for distribution to creditors over 30% more value than the valuation on which the plan was based ($14.6 instead of $11 million) and would leave a surplus after payment in full of all the claims given recognition in the confirmed plan. The question is whether the district court can refuse to consider modifications to the plan proposed by junior claimants, previously denied participation because of the insufficiency of the estate, to make appropriate disposition of the newly-arisen surplus.[4]

[4] Petitioners, the Kentucky Fuel creditors, contend that their interest claims are next in line and that they would be entitled to the surplus after payment to Columbia on its claims against Inland. While we agree with that contention, the important question here is not who is entitled to the surplus but whether the district court can refuse to provide for its disposition at all, allowing it to go as a windfall to whoever happened to have the residual stock interest in the earlier plan based on an outmoded valuation. It may be noted, however, that Columbia's contention that its remaining claims against the holding companies (see note 3, *supra*) would in any event be prior to the Kentucky Fuel creditors' interest claims is not only unsound as between those two claimants (see note 7, *infra*) but wholly ignores the existence of the public stockholders of Inland (see note 2, *supra*) who would necessarily share with the holding companies in any participation upon Inland stock.

1. Because substantial, and sometimes startling, increases in the value of a debtor's assets during the course of reorganization are common,[5] the question here is of broad and continuing importance. To a degree, of course, all going enterprise valuations are uncertain and mathematical precision in assuring that no creditor participates beyond his claim and that junior creditors participate in the precise degree that the "true" value of the estate allows is impossible. That, however, makes it all the more important that, to the extent practical and without disturbing vested rights, original estimates of value be revised when subsequent experience shows them to be erroneous and the

[5] See, *e.g.*, *Chase* v. *Austrian*, 139 F. 2d 555 (C.A. 4) (increase from $1.3 to $38 million during 8-year reorganization); *Chemical Bank Co.* v. *Investors*, 343 U.S. 982, 984 (annual earnings of railroad $18 million greater than original estimate). In numerous instances, the obligor has become solvent during reorganization. *E.g.*, *Knight* v. *Werthein & Co.*, 158 F. 2d 838 (C.A. 2); *In re Central States Electric Corporation*, 112 F. Supp. 281 (E.D. Va.), affirmed, 206 F. 2d 70 (C.A. 4); *In re Macomb Trailer Coach* v. *McInnis*, 200 F. 2d 611 (C.A. 6); *Standard Gas & Electric* v. *Deep Rock Oil Corp.*, 117 F. 2d 615 (C.A. 10); *Standard Gas & Electric Co., et al.*, 36 S.E.C. 247, 255. For other examples of substantial increases, see *In re Hotel Realty Co.*, 69 F. Supp. 345, 346 (D. N.J.); *In re National Food Products Corp.*, 23 F. Supp. 979, 984 (D. Md.); *In re Deep Rock Oil Corp.*, 113 F. 2d 266 (C.A. 10); *In re Midland United Co.*, 58 F. Supp. 667 (D. Del.); *In the Matter of Third Avenue Transit Corp.*, Civil Action Nos. 85851, 86410, 86412, 86413, 86537 (unrep.) (S.D.N.Y.); *In re Childs Company*, 69 F. Supp. 856 (S.D.N.Y.); *The United Corporation*, 13 S.E.C. 854, 878 and 35 S.E.C. 645, 648; *International Hydro-Electric System*, Holding Company Act Release No. 14080 (October 26, 1959); *In re Northern States Power Company*, 80 F. Supp. 193, 197 (D. Minn.); *Standard Power and Light Corp.*, 37 S.E.C. 1, 11; *Interstate Power Company*, 32 S.E.C. 239; *Missouri Pacific R. Co. Reorganization*, 290 I.C.C. 477, 627.

proposed distributions based on them to be inequitable. As put by Mr. Justice Frankfurter in *Bondholders, Inc.* v. *Powell,* 342 U.S. 921, 925:

> * * * All valuations based on estimates of future earnings are bound to be guesses in the sense of reaching into the future. That is a reason against, not for, turning guesswork into dogma and a reason for correcting bad guesses as much as is reasonably practical by hindsight. * * *

2. That the plan has been confirmed does not preclude the proposed modification, for under the statute it is consummation, not confirmation, of a reorganization plan that creates vested rights and precludes further substantial alterations. Section 222 of Chapter X provides that a reorganization plan:

> * * * may be altered or modified, with the approval of the judge, * * * before or after its confirmation if, in the opinion of the judge, the alteration or modification does not materially and adversely affect the interests of creditors or stockholders. If the judge finds that the proposed alteration or modification, filed with his approval, does materially and adversely affect the interests of creditors or stockholders, he shall fix a hearing for the consideration * * * of such alteration or modification. * * *

Section 229 defines substantial consummation and provides that:

> When a plan has been substantially consummated * * * the plan may not thereafter be altered or modified if the proposed alteration or modification materially and adversely affects the participation provided for any class of creditors or stockholders by the plan.

In short, changes which "materially and adversely" affect the creditors can be made only before consummation and only upon a hearing, while lesser changes can be approved by the judge without a hearing and may be made even after consummation. As to neither kind of change, however, is any distinction made because of confirmation; the only event that affects the power of modification is consummation.

We may assume that the modification proposed by petitioners "materially and adversely" affects Columbia within the meaning of §§ 222 and 229 and hence could not be made after substantial consummation or without a hearing. But consummation has not occurred and petitioners do not seek modification without a hearing. Hence there is no question of the power to make the modification under the statute, and the only question is whether petitioners have established a sufficient change of circumstances to warrant modifying the plan. The changed circumstance here, established at least *prima facie*, is a 30% increase in the value of the estate, producing a surplus over the claims of the participants in the plan and making possible a distribution to junior creditors who are now denied any participation. If ever a material modification can be made after confirmation of the plan, which the statute expressly contemplates and authorizes, a more compelling case for such a modification is difficult to visualize.

3. Notwithstanding the seemingly clear statutory language, the court below held that petitioners were not entitled to a hearing on their proposed modifica-

tion. The basis for its decision is not clear, but none of the possible explanations is supportable:

a. At one point the court seems to say that after confirmation the court can make only "such changes as will better aid in carrying out the plan which has been finally confirmed" and not "such changes or modifications as will materially alter the property rights established by the decree of confirmation" (Pet. 10c).[6] That statement flies in the teeth of the statute which makes consummation, not confirmation, the cut-off date; before that, the only difference between material and immaterial changes is in the requirement of a hearing, the statute expressly authorizing either kind of modification to a plan "before or after its confirmation."

b. Enumerating the differences between the plan and the proposed modifications in their technical details (the mechanism for payment of reorganization fees, the terms of the bond issues, etc.) and in the payment of Columbia in cash rather than stock, the court concludes that the proposals are more than "alterations and modifications" and constitute an "altogether new and different" plan (Pet. 6c). It

[6] The court relied on *Diversey Building Corp.* v. *Metropolitan Trust Co.*, 141 F. 2d 65 (C.A. 7). That case involved, however, a modification proposed after *consummation*, and the restrictive interpretation of § 222 there adopted to avoid upsetting consummated plans may have been justified by the lack of any statutory cut-off point short of the final decree. Section 229, however, was added in 1952 for that very purpose and thus undermines the basis for that decision. *Prudence-Bonds Corp.* v. *City Bank Farmers Trust Co.*, 186 F. 2d 525 (C.A. 2), also relied on by the court below (Pet. 11c), was similarly a pre-§ 229 case involving a post-consummation modification.

is hardly conceivable, however, that a financing which will produce $14.6 million for reorganization purposes would be in terms identical to one producing only $11 million or that a plan can be modified to provide for an added 30% of distributable values without some modification in the allocation of the residual stock interest. The modifications proposed here do no more than the minimum necessary to account for the increased value, and the holding that those changes go beyond permissible "modifications" means in effect that no plan can ever be modified to reflect subsequent increases in value.

Patently, we think, if the distinction between a "new" plan and an "alteration" to an existing one adds anything to the restraints imposed by the law of the case—which may, indeed, be questioned—the distinction must be made in terms of the substantial interests affected by the changes, not by an arithmetical adding up of the number of clauses in the plan that have to be rewritten. In those terms the modification here is fully consistent with the principles established by the prior rulings and embodied in the confirmed plan. It preserves fully the priorities and order of participation previously established and simply takes account of an increase in value not provided for by the confirmed plan. As valued for purposes of the plan, the assets were inadequate to pay Columbia in full on its claims, so that Columbia became the residual participant entitled to the common stock. The proposed modification makes available more than enough to pay Columbia in full in cash and leaves a residual participation for the creditors next

in line. No other substantive change is involved, and it is not apparent how that change results in an "altogether new" plan in any meaningful sense.

c. The court also asserts that the proposals "constitute an attempt to relitigate matters previously decided by this court" (Pet. 13c). All that was previously decided, however, was that the Kentucky Fuel public creditors were not entitled to payment of postbankruptcy interest *prior* to payment of principal and secured interest on the subordinated claims of Columbia; the claim now made is that the estate has so grown that there is a residue left *after* payment of Columbia's prior claims and that petitioners' interest claim is now next in line.[7]

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[7] If the court's opinion be read as extending its prior holdings that postbankruptcy interest in not payable prior to payment of junior creditors to a holding that postbankruptcy interest is not payable even after all other creditors have been paid in full, the decision is even more clearly erroneous and is in direct conflict with the numerous decisions recognizing the "solvency exception" to the disallowance of postbankruptcy interest—*i.e.*, the rule that postbankruptcy interest must in all events be paid before any distribution is made to the bankrupt or its stockholders. *E.g.*, *American Iron & Steel Mfg. Co.* v. *Seaboard Air Line Ry.*, 233 U.S. 261, 266–267; *New York* v. *Saper*, 336 U.S. 328, 330 n. 7; *Johnson* v. *Norris*, 190 Fed. 459, 463 (C.A. 5), appeal dismissed for lack of jurisdiction, 232 U.S. 715; *Littleton* v. *Kincaid*, 179 F. 2d 848, 852 (C.A. 4); *United States* v. *Bass*, 271 F. 2d 129, 130 (C.A. 9); *Marcalus Mfg. Co.* v. *United States*, 169 F. Supp. 821 (Ct. Cl.).

It is clear from the court's earlier opinions that the original disallowance of postbankruptcy interest to the Kentucky Fuel creditors was based solely on an application of the general bankruptcy interest rules. 241 F. 2d 374, certiorari denied, 355 U.S. 838; 262 F. 2d 510, certiorari denied, 359 U.S. 979. Columbia nevertheless contended below that, instead of applying the general interest rules, the court in its earlier decisions had lim-

d. Finally, the court at one point phrased its conclusion as being that the district judge "did not abuse the discretion expressly granted him" by the provision of § 222 allowing modification proposals to be filed only "with his approval" (Pet. 9c). In fact, however, the district court purported to rule only on the "legal premises" of the proposed modification (R. 78a), and the grounds for its decision were precisely the same as the other grounds relied on by the court of appeals—namely, that the proposal was an attempt to relitigate the previous denial of postbankruptcy interest to petitioners and that it constituted a "new" plan entirely inconsistent with the confirmed one and hence was not permissible under the terms of the statute. Nor does the court of appeals allude to any considerations on which a discretionary refusal to entertain the proposals might properly have been based.

3. The decision below is in conflict with the decision of the Second Circuit in *Knight* v. *Wertheim*, 158 F. 2d 838. In that case a reorganization plan had been confirmed under which the debenture holders

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ited the Kentucky creditors' participation as "quasi-creditors" of Inland to their principal claims simply as a matter of equity. Not only is that contention not supported by anything in the prior opinions, but such a ruling would have been inconsistent with the court's original finding that it was impossible to measure the extent of the damage caused the public creditors by Columbia's inequitable conduct. 151 F. 2d 461, 469. The contention is also disproved by the allowance of postbankruptcy interest to the public creditors of American Fuel, to whom precisely the same equitable principles were applied (the only difference being that the claims of the American Fuel creditors were secured, entitling them to interest before the payment of junior creditors under the general interest rules).

were to receive convertible income bonds for part of their claims and stock for the balance, with the stockholders also receiving a small amount of stock. Thereafter, the stockholders, claiming a large increase in the value of the property, proposed an alteration, supported by an underwriting offer, under which the stock of the new company would be sold to the old stockholders for sums sufficient to pay off in full the claims of the debenture holders, leaving the stockholders with the entire equity. The modification was opposed by the debenture holders—"as was readily understandable, since the price of the bonds had risen far above the amount of principal and interest" (158 F. 2d at 841)[8]—and, after extensive hearings, was rejected by the district court. The court of appeals, in an opinion by Judge Learned Hand, reversed, finding in § 222 ample authority for a post-confirmation modification to account for an unforeseen increase in the value of the estate and holding that none of the considerations urged justified denial of the proposal as a matter of discretion. That a plan had been finally confirmed after long years of delay was not a sufficient reason to deny the modification, since the debenture holders, who would be given interest until payment, would not lose anything they were entitled to by a further delay. And since the proposed modification guaranteed the senior claimants principal and interest

[8] So, also, Columbia's opposition here to a proposal to pay its claims in full in cash can be explained only on the ground that the present plan does in fact give it more than the total amount of its claims.

on their claims—"all the rights that a court need regard" (158 F. 2d at 843)—there was "no reason for depriving the shareholders of whatever chance might remain of realizing upon their property" (158 F. 2d at 843).

The only distinction that the court below was able to suggest between this case and *Knight* was that the alteration proposed there was more "simple" than that proposed here (Pet. 11c). In what substantial way the two alterations were different, however, the court was unable to say. Both cases involved neither more nor less than a proposal by junior claimants, made possible by a substantial increase in the value of the estate and supported by underwriting offers, to pay off the senior claimants in cash and take the residual equity for themselves. The cases are identical in all material respects,[9] and the decisions can be explained only as reflecting fundamentally different concepts of the duty of a reorganization court to modify an unconsummated plan when a substantial increase in the value of the property has made the original plan inequitable.

4. The court below emphasized the long duration of the reorganization proceeding in this case and the extensive litigation it has produced. The past

[9] The identity extends even to the fact noted below that the commitments of the underwriters have expired (Pet. 8c–9c, 12c), for the offer had similarly expired in *Knight*. Judge Hand's answer is equally applicable here (158 F. 2d at 842):

> * * * We cannot say on this record that the value of the debtor's property has so fallen in the past six months that the equity has for practical purposes disappeared; and indeed the strong resistance of the debenture holders to the appeal suggest that it has not.

history of the case, however, only emphasizes the anomaly of the court's present decision, for the very reason for the past delays has been a continuing increase in the value of the estate necessitating successive revisions of proposed plans to give junior creditors the benefit of the augmented estate. And it is particularly inappropriate that the specter of delay should be invoked in favor of Columbia, for it is only because of the extended delay that Columbia itself has become entitled to participate in the reorganization. Only six years ago a plan was approved under which Columbia was to receive nothing and the residual estate was to have gone to petitioners on their claims for principal. *In re Inland Gas Corp.*, 211 F. 2d 381 (C.A. 6). A subsequent increase in the value of the estate, however, produced a surplus available to Columbia on its subordinated claims and required substitution of the plan that has now been confirmed. Obviously that delay has been not prejudicial, but dramatically beneficial, to Columbia, and it is only petitioners—who are to be given no interest for the period during which the distribution to them was delayed for Columbia's benefit—who have been prejudiced. Moreover, in contrast to the denial of interest to petitioners during the delay beneficial to Columbia, the modification now proposed gives Columbia interest to the date of payment on the bulk of its claims (its secured claims), so that any further delay required to effect those modifications will not substantially prejudice Columbia. And since all the other creditors have already been paid in full (in-

terest as well as principal) on their claims,[10] there is no one else who can be affected by a delay.

In still another way the 30-year duration of these proceedings counsels for, rather than against, this final modification. Because of the inequitable conduct of Columbia precipitating bankruptcy, the public securityholders of Kentucky Fuel have had to wait 30 years for a return of their principal, and they remain the only class of creditors that has been denied interest for that period. It now appears that the estate is sufficient so that they too may be at least partially compensated for that delay, and that is the purpose of the proposed modification. That the delay, and hence the injury, has been great simply affords all the more reason for not forcing termination of the proceedings at the very point at which it becomes possible to provide a remedy for that delay, particularly where the result is to give a windfall to the adjudged wrongdoer ultimately responsible for the proceedings.

[10] The public securityholders of American Fuel, the last remaining class of creditors other than petitioners and Columbia, were paid during the pendency of the appeal in this case by agreement of the parties, their claims being unaffected by the proposed modification.

CONCLUSION

For the foregoing reasons the petition for a writ of certiorari should be granted.

Respectfully submitted,

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